



August 11, 2021

Submitted Electronically

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System,
20th Street and Constitution Avenue NW,
Washington, DC 20551

Re: Debit Card Interchange Fees and Routing; RIN 7100–AG15

Dear Ladies and Gentlemen,

The Wisconsin Bankers Association (WBA) is the largest financial trade association in Wisconsin, representing over 200 state and nationally chartered banks, savings and loan associations, and savings banks. WBA appreciates the opportunity to provide comment on the Board of Governors of the Federal Reserve's (FRB) proposal to amend Regulation II (Proposal).

FRB has proposed changes to revise Regulation II to require that debit card issuers should enable, and merchants should be able to choose from, at least two unaffiliated networks for card-not-present transactions. Changes would include revisions to the commentary to Regulation II to define that card-not-present transactions are a particular type of transaction for which two unaffiliated payment card networks must be available. Further revisions to the commentary would address the responsibility of the debit card issuer in ensuring that at least two unaffiliated networks have been enabled to comply with the regulation's prohibition on network exclusivity. In addition to these changes, FRB has proposed revisions to certain terms and phrases in the commentary. FRB has requested comment on all proposed changes to the rule and commentary.

WBA requests that FRB withdraw the Proposal to amend Regulation II. The Proposal comes at a time where our members have maintained payments products to support Wisconsin consumers and businesses, including facilitating various stimulus programs throughout the pandemic and lockdown periods. It is disappointing and unexpected that at this time FRB would propose a rule which would require distracting, expensive, and time-consuming efforts on behalf of Wisconsin banks to change their core network infrastructure. Particularly so given that the primary beneficiaries of the Proposal would be large multinational retailers who have experienced significant profitability increases during the pandemic. The Proposal would bring unnecessary changes to the overwhelming benefit of some of the largest merchants, at the expense of issuers and consumers. It is a distraction, at a time when distractions are least needed.

WBA is also concerned with FRB's overall approach in the Proposal. Particularly, its lack of consideration of probable harm to small businesses and consumers. For the reasons discussed below, WBA respectfully requests that FRB withdraw the Proposal until it undertakes a proper analysis of the impact of any further rulemaking on routing and exclusivity.

Introduction

FRB issued a final rule implementing Regulation II's prohibitions on network exclusivity and routing restrictions in July 2011. WBA commented in opposition of the government-set price controls presented in the proposal leading up to the final rule. WBA appreciates FRB's attempts to clarify certain aspects of that rule, but the Proposal extends far beyond the act of mere clarification. Rather, the Proposal represents a substantive shift in the routing and exclusivity provisions of Regulation II. Furthermore, the Proposal fails to consider its practical and operational implications. Perhaps most significantly, WBA is concerned that the Proposal does not reflect a change with consumer protection in mind, rather, it represents a significant financial windfall for large retailers.

WBA is aware of data concluding that the winners from Regulation II's network exclusivity and routing restrictions have been the nation's largest retailers. These retailers have negotiated discount rates with specific networks to cover card-present transactions and are seeking to extend those discounted rates to card-not-present transactions. Smaller merchants generally do not receive such benefits, and there is no evidence that the larger merchants pass interchange savings onto their customers. Instead, cardholders have seen free-checking and rewards programs withdrawn and new fees introduced by financial institutions needing to make up revenue lost to complying with Regulation II requirements.

Despite this, FRB has proposed to further extend the benefits to large retailers, which will in turn amplify the harms to issuers and customers. Under current Regulation II consumers have not seen benefits passed along from the merchants, instead, their relationships with issuing financial institutions have been harmed, and, as discussed further in this letter, WBA is concerned that the Proposal will only exacerbate this effect. Additionally concerning, is that the Proposal would force issuers to partner with networks that have not proven their ability to handle fraud security in the area of card-not-present transactions, which are traditionally more prone to fraud. For these reasons, WBA believes FRB should withdraw the Proposal until it can complete a fuller impact analysis. If FRB decides to proceed with the rule as proposed, WBA has presented a number of changes which, at a minimum, we believe are necessary in order to begin to address the issues discussed.

Discussion

Enablement Provisions

WBA is concerned that the Proposal's enablement provisions are vague, which would result in compliance uncertainties, as well as unnecessary drains upon bank resources. The Proposal would amend the enablement requirements to require that, for every particular type of transaction for which the issuer's debit card can be used to process an electronic debit transaction, the issuer must enable at least two unaffiliated payment card networks to process the transaction.

These obligations would apply to any debit transaction, whether the card is present or not, and would require issuers to ensure that at least two unaffiliated networks are "enabled" on their cards. FRB states this amendment is "to emphasize the issuer's role in configuring its debit cards to ensure that at least two unaffiliated networks have been enabled." It is clear that FRB's intent is for the issuer's role to extend beyond "allowing" processing on at least two unaffiliated networks or contracting with network providers with the capability of meeting Regulation II's network requirements. A problem with this approach is the vagueness of the new obligations

which would be imposed upon issuers for **all** electronic debit transactions. The Proposal does not, however, specify the steps issuers must take to ensure enablement. While issuers are generally familiar with how their cards work with their network partners, the Proposal would create uncertainty as to whether those processes comply with the proposed requirements. As currently proposed, the revisions create only vague expectations, which leave issuers with no basis to determine whether their existing steps are those that would meet the Proposal's expectations.

FRB states that it does not intend these amendments as a substantive change to the section but rather as a clarification of the existing language. Regulation II currently states that an issuer satisfies the prohibition on network exclusivity requirements only if the issuer allows an electronic debit transaction to be processed on at least two unaffiliated networks, each of which does not, by rule or policy, restrict the operation of the network to a limited geographic area, specific merchant, or particular type of merchant or transaction, and each of which has taken steps reasonably designed to enable the network to process the electronic debit transactions that the network would reasonably expect will be routed to it, based on expected transaction volume. FRB's proposed amendments regarding enablement go beyond clarification. Issuers must rely on what capabilities the networks provide them and accept what it takes to enable them. As a result, issuers are not situated to understand and implement the enablement requirement on **every** debit transaction. Additionally alarming, is the scope of the revisions, which would apply to further, future developments. It is unreasonable to expect issuers to create processes and frameworks to accommodate a payment system that has not been developed yet.

Furthermore, the Proposal presents the issue as a matter that should be borne by the issuers alone, despite being a matter which should fall within others in the payment ecosystem. As discussed within the Proposal, some networks have developed capabilities that depart from their primary messaging approach. For example, some traditionally dual-message networks can now process certain payments using a single message. Similarly, some traditionally single-message networks can use two messages to authorize and clear some transactions. If merchants seek to conduct more card-not-present transactions through multiple networks, they have that ability. They have the capability to build that system in partnership with their acquirer and others within the payment ecosystem rather than be forced upon the issuer. As recognized by FRB, that capability is there, and should be at the initiative of all parties within the payment ecosystem

The proposed enablement requirements would require an unnecessary expenditure of bank time, funds, and personnel. WBA is concerned that some smaller financial institutions may not have adequate resources to implement necessary systems. Such institutions would be forced to rely on vendors, for which there are limited options who are capable of the task. The overall effect would be to redirect funds and effort these issuers would otherwise use on projects, services, and low-cost products offered to their customers.

If FRB proceeds with a final rule, WBA recommends that it consider the burdens to all impacted parties. Specific to enablement provisions, WBA believes FRB should conduct further analysis of the appropriate steps necessary to enable multiple unaffiliated networks on cards. Additionally, it should specify which transaction types specifically are at issue. This would help issuers better tailor, test, and approve any new systems they build, so that they are best suited to meet the enablement requirements, particularly given the ever-changing nature of the payments landscape.

Risks Associated with Card-Not-Present Transactions

FRB has proposed revisions to specify that card-not-present transactions are a particular type of transaction for which issuers must ensure at least two unaffiliated payment card networks have been enabled. FRB indicates that at the time it promulgated Regulation II, for card-not-present transactions, such as online purchases, the market had not developed solutions to broadly support multiple networks over which merchants could choose to route those transactions. FRB further discusses that in the decade since the adoption of Regulation II, technology has evolved to address these barriers, and more networks have introduced capabilities to process card-not-present transactions. Thus, this aspect of the Proposal is based, in large part, upon the idea that, because of these technological evolutions, issuers should adopt personal identification number (PIN) debit networks for card-not-present transactions. However, such transactions present more than technological concerns, and WBA is concerned with the risks that this requirement will introduce to the payment system.

Single-message networks, which developed from automated teller machine networks, typically authorize and clear a transaction through a single message and have traditionally processed transactions authenticated using a cardholder's PIN. The use of PIN debit networks has been the preference in terms of protection against fraudulent use of lost or stolen cards. Only recently have retailers switched to a preference for PIN-less, card-not-present transactions, which has occurred only due to significant discounts offered by single-message networks. In short, the variance in views on PIN debit network preferences depends on economic interest versus security and fraud protection. Whereas the push for PIN-less networks comes purely from the economic interests of large retailers, the viewpoint of issuers, and Wisconsin banks, is focused on combatting fraud and consumer protection. WBA opposes the Proposal's expansion of PIN debit networks which comes at the cost of anti-fraud security.

Increased Costs

Along with increased fraud, comes increased costs. Wisconsin banks would face significantly increased costs in order to combat this effect of the Proposal. Further costs are expected to occur due to fraud-based losses and identify-theft. Furthermore, WBA expects that issuers will need to work directly with PIN networks to build solutions for their debit networks in the card-not-present environment. Specifically:

- Help their new networks develop fraud-scoring and monitoring systems to help identify potential fraud,
- Help set up new methods to spot and decline transactions in the case of a fraud attack,
- Develop systems to ensure that networks have the capability to identify and decline unverifiable transactions when the issuer is unavailable, and,
- Help the PIN networks they're compelled to enable build an entirely automated claims process for card-not-present transactions.

These are the minimum protections WBA believes necessary, and it will require issuers to work proactively, and directly with the networks to implement. If they did not, and the networks handled such claims manually, consumer harm and issuer liability would be inevitable. Without these protections, further liability for consumers and issuers will result with strains issuers already face under Regulation E.

This is just one example of the necessary steps that issuers must take in order to meet oversight responsibilities that will result if the Proposal is finalized. Additional requirements include major modifications that issuers would be required to undertake within their own systems to enable PIN networks for card-not-present transactions. This process alone will require technology changes to modify authorization, settlement, support staff, revisions to policies and practices to reflect new network rules, and training. This process will invariably require a significant investment of resources, and time. WBA estimates that these changes will take three to four years.

WBA anticipates that while all institutions will be burdened with the lift required by these necessary revisions, these changes will fall most heavily on smaller issuers and community financial institutions. Smaller issuers may face greater struggles negotiating with a national network. WBA is concerned that this, combined with the overall burdens discussed above, will directly affect these institutions' ability to offer affordable, core deposit products like free checking. Furthermore, it's obvious that the work needed to enable additional networks cannot happen at once. It's likely that smaller financial institutions will be at the back of a long line of banks needing to contract with various additional networks. In totality, the risks and costs associated with the Proposal, makes it clear that FRB's revisions present more than a clarification of existing routing and exclusivity requirements. Rather, it is a burdensome overhaul and further convolution of compliance which threatens the ability of many community financial institutions to meet the needs and provide security for their customers.

FRB Should Undertake Further Analysis Before Issuing a Final Rule

As discussed above, while FRB presents the Proposal as a clarification, the revisions and their implications are far more serious. It imposes new, vague responsibilities on issuers for all transaction types that do not currently exist under Regulation II. To this extent, WBA believes it would be beneficial for FRB to conduct an economic impact analysis before proceeding further. Specifically, an analysis discussing the economic impact resulting from a rule that benefits large retailers but touches all parties in the payment ecosystem. Consideration should be made as to the harm that will result to issuers and the implications which provide increased avenues for criminal activity.

In the brief analysis FRB does provide, it discusses that "with respect to the availability of services to different classes of consumers, particularly low-income consumers, consumers are typically unaware of the networks used to process many debit card transactions today, including card-not-present transactions where at least two unaffiliated networks are already available. In general, cardholders don't have concerns because they don't know how their transactions get routed. However, cardholders are frustrated when other bank costs increase because they don't make the connection on how these types of changes impact overall costs.

Regardless, FRB cannot justify its lack of analysis based upon consumer ignorance. Instead, FRB must provide an analysis of the impact upon consumers. The Proposal does not explore any benefits, or harm, and instead, FRB indicates that "ultimately, the costs and benefits of the proposed revisions are uncertain..." This analysis is insufficient, particularly as WBA believes that, if finalized, the Proposal would indeed result in consumer harm. The Proposal will harm consumers regardless of whether they are "unaware" of the networks used to process transactions.

WBA believes this to be the case based upon how consumers have been affected under current Regulation II's requirements. Consumers have not experienced any benefit from the savings

that merchants have experienced under Regulation II, because merchants have not passed those savings on to consumers. Instead, the result has been to harm consumer relationships with their financial institutions, as the regulation has forced issuers to discard rewards programs, and impose new checking fees to make up revenue from the present rules. It's easy to predict that the Proposal, which would expand upon the current regulation, would only exacerbate these negative effects.

Further Impact on Small Issuers

FRB states that because the proposed amendments apply to all issuers regardless of their size, they are unlikely to have an effect upon competition among large and small financial institutions in the provision of electronic fund transfer services. This disregard of any concern over the Proposal's potential effects on smaller issuers is alarming. The fact that all issuers will be impacted by the Proposal cannot be the end of FRB's analysis into the scope of its impact. As discussed above, the impact on issuers includes compliance costs, implementation costs, and increased fraud-related losses.

Small issuers will face these issues with greater struggles, due to a lack of the levels of experience possessed by larger issuers in overseeing networks, ensuring compatibility, and overall, more fraud loss due to a lack of more sophisticated technology. WBA is concerned with the impact that this may have on smaller banks' ability to continue to offer convenient deposit products, without having to impose additional fees to sustain the costs associated with the Proposal.

FRB Should Withdraw the Proposal

WBA believes that FRB should withdraw the Proposal and conduct further analysis of the potential harms which we believe outweigh the benefits. Even if FRB believes that the effects on payment systems remain uncertain rather than harmful, withdrawal and further review is appropriate. WBA cautions against moving forward with a rule, given any uncertainty, where consumer security, wellbeing, and community financial institution survival is at stake. For these reasons, WBA urges FRB to begin again, starting with an analysis in accordance with good policymaking, and in consideration of the totality of impacts of further rulemaking in this area.

At a minimum, if FRB decides to move forward with the Proposal, it should remove the "enablement" provisions. Instead, it should use the original language which requires that issuers "allow" multiple networks on their cards. If FRB retains the "enablement" provisions it should specify more precisely what expectations are placed upon issuers and others in the payment ecosystem to enable multiple networks, so issuers are able to understand what is required in order to comply with the rule. FRB should also specify the specific transaction types at issue, that must be capable of being routed on multiple networks. Lastly, FRB should permit four years for compliance, in order to provide issuers with an adequate timeline to come into compliance.

Conclusion

WBA appreciates the opportunity to comment on FRB's proposal to amend Regulation II. The Proposal does more than simply clarify matters and instead represents a reworking of the network exclusivity and routing requirements. If the Proposal is finalized, it will increase costs on consumers and issuers during an already challenging time. WBA requests that FRB withdraw the Proposal and begin again with a fuller analysis. If FRB decides to proceed, it should revise the Proposal as discussed above.

We appreciate your consideration of these comments.

A handwritten signature in black ink, reading "Rose Oswald Poels". The signature is written in a cursive, flowing style.

Rose Oswald Poels
President/CEO